FROM 30 TO 40: GOALS AND DISCIPLINE

PROFILE

35-year-old couple with two young children. One partner earns $74,000 while the other works part time earning $30,000. Savings goals include owning their home and education costs. Average super balance for a 35-year-old man, $52,700; for a woman, $39,600.

SAVINGS NEEDED

$800,000 in today's dollars to last until the couple reach 90; $1.76 million in 2045 dollars.

HOW TO GET THERE

- Write down your goals and stick to them.
- Pay off the $400,000 mortgage in 28 years.
- Save $120,000 for education costs.
- Balanced investment option.
- Increase savings if falls in the market affect super.
- Both work full time when the children are older.
- Superannuation guarantee, currently 9.25% and rising to 12% in 2031. Will accumulate over 32 years.

HOW TO MAKE IT LAST

- Pay off the mortgage before you retire.
- Switch superannuation to an asset-based pension that is invested in a moderately conservative option (50% growth and 50% defensive).
- Monitor the plan once a year.
- Don't sell out of growth assets in poor market conditions.
- Work with an expert who has an objective opinion and can help you make the right decisions.

EXPERT
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For many, **emotions can get in the way** of making smart decisions

GETTY IMAGES

AT 35, THIS COUPLE ARE experiencing a very expensive period of their lives – raising a family, balancing lifestyle and work, along with paying off the mortgage. At the same time they have hopes and dreams in life that they would like to achieve.

They have 32 years until retirement, so time is on their side. Their superannuation fund will fund their retirement goal. Based on employer superannuation guarantee payments on current incomes inflated at 2.5% a year, they have a high probability of achieving their desired income of $60,000 via an account-based pension at retirement. The age pension would be needed to help them achieve this income.

To give them a 75% probability of reaching $60,000 a year in retirement, they should be targeting a combined superannuation balance of around $800,000 in today's dollars. By 2045, when they are 67, they will need $125,854 a year and the future value of their super would be $1,763,000.

It is best to select a balanced portfolio (70% growth and 30% defensive assets) for their super fund's accumulation phase. This is the default asset allocation for most super funds. Switch to a moderately conservative portfolio (50% growth and 50% defensive assets) at retirement.

There are a few important steps we would recommend before even contemplating what the best investment strategies should be to reach their goals. These steps will ensure they have a higher probability of getting to the right outcome with the focus being on what is important to them.

Step 1: Write your goals down. It sounds simple but very few of us do this and fewer still put details to those goals such as: How much? For how long? And by when?

Using these same principles this couple have mapped out their three major goals:
Goal 1: Own home – pay out mortgage of $400,000 by January 1, 2035 (22 years).
Goal 2: Children's tertiary education – need $20,000 a year for each child for three years. First child: years 2025-27; second child: 2027-29.
Goal 3: Financial independence by July 1, 2045 (age 67). Desired annual income $60,000 (today's dollars indexed 2.5%), to age 90.

Other important details to consider are:

- How much can you save each year before your retirement?
- What portfolio risk are you willing to take on?
- What current assets do you wish to dedicate to each goal?
- What certainty do you wish to have that your goal works out at least as well as you've planned?

Step2: Determine your flexibility. I am not saying that the target for retirement should be flexible but for many people some factors around which we define financial independence are flexible.

For example, the couple would prefer less up and down movement in their portfolio value but are willing to take more risk in their investment portfolio if necessary to increase their chances of reaching their goals. Also they could possibly save $5500 a year if they really put their mind to it.

Step 3: Rank your priorities. Prioritise what is most important to you relative to your goals. Sometimes you may have to make trade-offs unique to your preferences and values.

This couple strongly want to fund their children's tertiary education as they view this as a good start in life for their children. They list this as priority one. They also believe that paying off the home sooner would give them some peace of mind. However, they are willing to extend the loan period if required for the sake of the children's tertiary education.

Step 4: Calculate the certainty. We measure the certainty of reaching these goals by determining the probability that your plans work out, using portfolio expected returns and probability calculations. This is a complex process that a good adviser will adopt. Many make the mistake and project performance, based on the past, and calculate that into the future. It is improbable to use a straight line projection of, say, 7% growth year-on-year. We all know it is impossible to guarantee a particular return in a particular year. Investments go up and investments go down.

Step 5: Consider investment strategies and priorities and flexibilities. Currently our couple make the standard 30-year term repayments on their home loan of $400,000, which equates to $2232 a month (a comparison rate of 5.34%pa).

They have no savings plan in place to fund the tertiary education and currently their only other investment is their compulsory superannuation combined balance of $90,000 plus standard employer super guarantee contributions (9.25% for 2013-14 rising to 12% by 2021-22). (Actuaries Rice Warner say studies show the average super balance between 35 and 39 was $52,700 for men and $39,600 for women at July 2012.)

Based on their current situation, they would not be able to reach their long-term goal of funding the tertiary education for their children or pay off their mortgage any sooner than the standard 30-year term without considering the following steps:

- **Strategy for education funding**: A disciplined savings plan is needed to meet the tertiary education goal. We would recommend that they save $5300 a year for the next 17 years ($440 a month) to an insurance bond invested in a high-growth portfolio. Insurance bonds can be tax-effective investment vehicles for individuals working towards long-term goals. The tax on earnings is paid within the insurance bond, at a rate of up to 30%, rather than at the individual's marginal tax rate. This couple could place the investment in the wife's name but, long term, the benefit of no capital gains tax after 10 years is attractive. Also she may return to full-time employment
- **Strategy to pay down home loan sooner than the 30-year term**: On the completion of the children's tertiary education funding, we would then recommend that the $5300 savings be diverted to the mortgage. This will reduce the time of payout from the year 2043 to 2040. Any increases in salary can be directed to shorten the term of the loan (and the interest paid).

Step 6: Implement, monitor and adapt. At least once a year you should monitor your plan – whether you're tracking relative to expectations. If results are on track, all is good, but on the other hand if there's been poor market conditions this may mean you'll fall short of your goals.

Most investors respond to poor market conditions by selling out of growth assets at just the time those assets are inexpensive. This would be a poor financial decision – the best action would be to respond based on your priorities. For example, you may consider an increase in savings.

For many, emotions can get in the way of making smart decisions and this is why it is important to consider getting a third objective opinion. A financial adviser can assist you in working through the six steps and help to establish a plan that provides reassurance and confidence about the decisions you are making, without taking panic decisions based on the next end-of-the-world article or advice from your work colleagues in the lunchroom.

The third objective person you hire should be able to lead, educate and inspire you to work towards reaching the goals that are most important to you.